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SUBJECT: KAZAKHSTAN: THE U.S. IOC BIG THREE AND KMG

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11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: Senior executives from the three largest U.S. investors in Kazakhstan -- ExxonMobil, ConocoPhillips, and Chevron -- spoke recently about their companies' plans, priorities, and problems with the biggest oil exploration, production, and transportation projects in Kazakhstan. They also provided insight into the leadership and management of national oil company KazMunaiGas (KMG). END SUMMARY.

KASHAGAN COMPLICATIONS

13. (SBU) On January 13, Patty Graham, Director of Government Relations for ExxonMobil Kazakhstan, told Energy Officer that she is concerned about the slow pace of progress on the 40-year, \$136 billion Kashagan project. The North Caspian Operating Company (NCOC) that oversees the Kashagan consortium is "a vast improvement" over Agip's management of the project, but the partners are nevertheless "really struggling" to make decisions, she said. (NOTE: The date for commercial production at Kashagan has shifted repeatedly, from 2005 to 2008 to a current target of the 4th quarter of 2012. END NOTE.) Graham underlined that the consortium must make a number of major, pre-investment decisions in the near future, and expressed concern that the government's reluctance to commit the necessary funds would adversely impact the project schedule. She said the approvals process has been very slow, and that invoices and requests for reimbursement are very carefully scrutinized. (NOTE: On January 15, KMG President Kairgeldy Kabyldin suggested in a press conference that the 2010 budget for the Kashagan project should be reduced by nearly \$3 billion, from \$10 billion to \$7 billion. END NOTE). Graham added that construction work at Kashagan nearly came to a halt at the end of 2009 when the project's environmental permit expired. The government finally approved a new annual permit on December 29, averting a crisis that would have cost the consortium

millions of dollars, she stated.

KMG CONFLICTED

¶4. (SBU) Graham highlighted national oil company KazMunaiGas' (KMG) complicated, and often conflicted, dual role on the project, as an equity partner with 16.81% ownership in Kashagan, and as the government's recognized authority that must approve investment and other decisions. According to Graham, KMG's senior managers are trying to run the company on commercial terms according to best business practices, but ultimately, political directives win the day. Graham mentioned that the private-sector partners of the Kashagan consortium often meet without their KMG counterparts, because their internal deliberations are leaked to the government. This situation, she asserted, has not helped to build trust and confidence among the consortium.

THE DECISION-MAKERS AT KAZMUNAIGAS

¶5. (SBU) Graham called KMG President Kairgeldy Kabyldin a "straight-talking bureaucrat," passionate about pipelines, who takes direction from President Nazarbayev's son-in-law Timur Kulibayev, the Deputy Chairman of National Welfare Fund Samruk-Kazyna, which owns KMG. She revealed that KMG First Vice President Maksat Idenov has had his portfolio sharply restricted, but did not speculate on the reasons. Idenov, who formerly managed KMG's stake in Tengiz and led negotiations on the Kazakhstan Caspian Transportation System (KCTS) for the government, now only oversees Kashagan and Dunga, a small, onshore oilfield in Mangistau oblast operated by Denmark's Maersk Oil Kazakhstan. "Maksat is a man of principle and a good businessman," she said, "but (KMG Managing Director for Exploration and Production Askar) Balzhanov has taken over everything." Graham also called NCOC Deputy Director Zhakyp Marabayev "a reliable

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partner" who is "doing a great job. He is the only reason we were able to get our environmental permit when everyone was on vacation at the end of the year" (reftel A).

NAZARBAYEV CRITICIZES KMG'S HIRING AND PROMOTION PRACTICES

¶6. (SBU) Graham described the talent pool at KMG as shallow and highlighted ExxonMobil's difficulty in identifying qualified applicants for long-term training in the United States. She also asserted that appointments and promotions of KMG managers often depend on family ties rather than technical knowledge or job skills. In unusual public criticism, President Nazarbayev himself appeared to confirm this claim. According to an article published in "Kazakhstanskaya Pravda" (a semi-official government newspaper) on December 25, 2009, Nazarbayev criticized the top managers of KMG and its subsidiary, KMG Exploration and Production (KMG EP). "It has been proven that the existing management system is inefficient," Nazarbayev said in a statement from the President's press office. "KazMunaiGas has a four-level management system, and KazMunaiGas Exploration and Production a five-level system. In both companies, the number of support departments and services is higher than that of the production units," the statement underlined.

¶7. (U) Subsequently, an inspection of KMG by the Presidential Administration found that "the companies do not comply with the qualification requirements for hiring and promoting employees." The article claimed that more than 40% of senior managers at KMG and KMG EP do not satisfy the experience and educational requirements defined in their job descriptions. The inspection found that some department directors supervise only three or four people while others supervise as many as 30 employees. It also reported that salaries paid to senior managers are "unreasonably high." According to the article, President Nazarbayev instructed the inspectors to determine whether KMG and KMG EP employ relatives of high-ranking officials. According to the report, 7.5% of KMG staff and 2.7% of KMG EP staff are relatives of other government officials, including 17 employees who are related to heads of other government agencies, eight to parliament members, nine to directors of the inspected companies, and seven to former heads of various governmental agencies. Nazarbayev ordered the leaders of KMG and KMG EP to take immediate steps to improve transparency and efficiency at the

companies. He additionally tasked Aslan Musin, head of the Presidential Administration, to ensure that those who committed violations would be held accountable.

KCTS WILL STILL NEED THE IOCS

18. (SBU) In brief comments on the Kazakhstan Caspian Transportation System (KCTS), Graham reported that KMG's Kabyldin has made it clear that the government will continue to insist on 100% equity in the pipeline and marine infrastructure. However, even if the international oil companies (IOCs) do not own the assets, she underlined their continued expectation of guarantees on the reliability/safety of the infrastructure, access to the pipeline and tankers, and the stability of tariff rates before they commit their crude to the system. Graham said that even with financing provided by the export-credit agency of France, KMG would still not be able to meet the financial terms of the project. She speculated that additional subsidies from the government of France might be forthcoming (reftel B).

19. (SBU) According to the UK Energy Officer in Astana, who met with Kabyldin on January 12, credit lines are already in place with the French and Japanese export-credit agencies, and KMG expects to conclude negotiations with the French consortium by August 2010. Kabyldin said the completion of negotiations would guarantee credit from French and Japanese commercial banks to build KCTS. When asked whether KMG would build KCTS without volume commitments from the IOCs, Kabyldin reportedly replied that the renegotiated October 2008 Kashagan contract requires the IOCs to use Kazakhstani transportation infrastructure if it meets international standards. Kabyldin assured the UK Energy Officer that KMG would guarantee the

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IOCs a fixed tariff and long-term access to KCTS in exchange for their volume commitments.

EITI VALIDATION

110. (SBU) As a member of Kazakhstan's National Stakeholders Council under the Extractive Industries Transparency Initiative (EITI), Graham provided an update on Kazakhstan's EITI validation efforts (reftel C). She said that the external validators rated Kazakhstan's progress as satisfactory for 15 of the 18 indicators and requested additional information about the remaining three indicators. While Graham was pleased about the validators' general satisfaction with Kazakhstan's progress, she expressed frustration about the government's apparent unwillingness to dedicate the time and resources necessary to complete the process. "They simply won't engage," she stated, noting the refusal of KMG's Kabyldin to meet with the validators during their December 2009 visit to Astana. Graham also mentioned the recommendations by a coalition of civil society organizations involved in the EITI process to downgrade Kazakhstan on all 18 indicators and negotiate a new memorandum of understanding. She acknowledged NGOs' concern that they will lose negotiating leverage with the government once Kazakhstan achieves validation, but argued that it is unreasonable to expect all 122 parties to renegotiate the MOU at this stage. With the rapidly approaching deadline of March 9, Graham underscored the need for quick government action to respond to the validators' request for information. "Kazakhstan has a chance to make positive headlines just as it assumes leadership of the OSCE," she said. "This is a good news story waiting to be written. It would be a shame if they missed this opportunity."

CONOCO CONFIRMS KASHAGAN DIFFICULTIES

111. (SBU) On December 11, 2009, ConocoPhillips regional president Colette Reynolds described to Energy Officer the Kashagan consortium's difficulty in convincing the government's recognized authority, KMG, to invest in Phase II expansion activities. "There's still a lot of baggage" from the delays and cost overruns that led to the restructuring of the original agreement, she said.

WILL THE FRENCH BUILD THE ESKENE-KURYK PIPELINE?

¶12. (SBU) Reynolds also asserted that the Kashagan consortium is exploring new oil-export options, including a rail transportation project that would carry sulfur and early oil from Kashagan (up to 300,000 barrels per day). According to Reynolds, the door remains open for U.S. companies to play a significant role in KCTS, including equity ownership of the Eskene-Kuryk pipeline. She noted that Minister of Energy Mynbayev was "extremely emphatic" that no deal had been struck with a consortium of French companies to build the pipeline. "It's just an option on an early engineering study to facilitate the government's access to finance," she said.

¶13. (SBU) On December 14, 2009, Jay Johnson, Managing Director for Chevron's Eurasia Business Unit, told Energy Officer that KCTS negotiations have stalled. He claimed the project has received no volume commitments from any of the major Western oil producers in Kazakhstan and expressed skepticism that the French consortium could raise sufficient funding to construct the Eskene-Kuryk pipeline without such volume commitments.

CPC EXPANSION APPROVED

¶14. (SBU) Johnson emphasized Chevron's priority is expansion of the Caspian Pipeline Consortium (CPC) pipeline. He mentioned a planned CPC Board meeting in Moscow on December 15-16 to sanction expansion and confirmed BP's withdrawal from the Consortium, thus removing the last obstacle to a positive decision on expansion. However, he cautioned that "each company in the Consortium is pushing its own interests." (NOTE: Graham verified on January 13 that the CPC Board sanctioned expansion of the CPC pipeline and approved pre-FEED

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activities. She was not aware of any demands from the government of Russia that the CPC companies build a new 100 metric ton oil terminal in Novorossisk, north of current terminal. END NOTE.)

CHEVRON SKEPTICAL ABOUT SAMSUN-CEYHAN

¶15. (SBU) Calling the Samsun-Ceyhan pipeline a "political project," Johnson said Chevron would prefer to evacuate its crude from the Black Sea via Suez supertankers through the Bosphorus, or via a future Bourgas-Alexandropolous pipeline. He noted that the latter would likely be more competitive, because it transits Bulgaria and Greece, whereas Samsun-Ceyhan would be located entirely on Turkish territory, thus giving the Turks greater leverage over shippers (reftel D).

¶16. (SBU) COMMENT: It was a pleasant surprise to see President Nazarbayev holding senior government officials publicly accountable for results and operational efficiency. It was also rare -- but welcome -- for the Presidential Administration to conduct an unannounced inspection of a state-owned company and investigate allegations of nepotism, waste, and redundancy. We suspect that Presidential Advisor Nurlan Balgimbayev, a founder of the national oil and gas company and a close personal friend of Nazarbayev's had a hand in the decision. We can only hope that Nazarbayev's emphasis on efficiency will translate into an accelerated pace on projects such as Kashagan and KCTS, in which the government, and U.S. companies, have a significant interest. END COMMENT.

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